NEW CENTURY℠
MORTGAGE CORPORATION

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VIA FACSIMILE

Regulation Comments
Chief Counsel's Office
Office of Thrift Supervision
1700 G Street, NW
Washington, DC 20552

Re: Docket No. 2002-17
Comment on Proposed Rulemaking

To the Office of the Chief Counsel:

New Century Mortgage Corporation welcomes the opportunity to comment on the Office of Thrift Supervision's ("OTS's") proposed changes (the "Proposed Rule") to the regulations implementing the Alternative Mortgage Transaction Parity Act (the "Parity Act").

New Century is a California corporation that originates non-prime residential mortgage loans in all fifty states. We are a *non-depository state housing creditor* as that term is used in the Notice of Proposed Rulemaking published in the April 25, 2002 Federal Register. In 2001, we originated over $6.2 billion in non-prime mortgages to over 45,000 borrowers, making us one of the country's largest non-prime mortgage originators. The vast majority of our loans are adjustable-rate mortgages that are considered alternative mortgage transactions under the Parity Act.

The OTS's proposal appears to be motivated at least in part by a concern that unscrupulous lenders are relying on the Parity Act's federal preemption to engage in abusive lending practices that would otherwise be prohibited under state laws. We commend the OTS for its desire to prevent abusive lending practices. New Century has been a leader in the development of controls and other "Best Practices" to prevent abusive lending. A copy of our Best Practices is attached to this letter as Exhibit A.

Despite the OTS's good intentions, however, we have significant doubts regarding the Proposed Rule's effectiveness in reducing abusive lending practices. More importantly, we are concerned that the Proposed Rule will have the unintended consequences of placing state housing creditors at a competitive disadvantage, increasing their compliance costs and dampening secondary market demand for their products. We fear that these consequences would in turn limit the availability and increase the cost of credit. We

respectfully submit that an environment of limited access to credit and minimal competition is more ripe for the very abusive practices that the OTS wishes to prevent.

I. The Proposed Rule Eliminates Parity

Congress enacted the Parity Act in 1982 to "*...make more housing credit available by giving those state-chartered housing creditors parity with federally chartered institutions and eliminate the discriminatory impact of the state laws by authorizing those creditors to make, purchase and enforce alternative mortgage loans.*" The Parity Act and the OTS Regulations that implement it have enabled state-chartered housing creditors to compete on a level playing field with federally chartered thrift institutions in offering variable-rate mortgage loans.

If the Proposed Rule is adopted, such competition will be eliminated inasmuch as state housing creditors will be subject to state prepayment penalty laws whereas federally chartered institutions will not. The state laws pose challenges on several fronts.

A. Origination and Compliance Costs Will Increase

First, state housing creditors' compliance costs will increase as new forms, policies, procedures and controls are implemented to comply with yet another state-specific standard supplanting a uniform federal standard.

B. Secondary Market Costs Will Increase

Likewise, the secondary market for variable rate mortgages will be weakened as investors face additional due diligence costs (and potential risks) as they review pools of mortgages against the widely varying state law requirements and restrictions on prepayment charges. These costs will be passed on, directly or indirectly, to state housing creditors.

C. Ability to Offer Loans with Prepayment Charges Will Be Limited

Finally, even if a state housing creditor can bear the additional compliance and secondary marketing costs, in many cases the creditor will be prohibited or severely restricted from offering its customers loans with a prepayment charge.

Prepayment charges play a particularly important role in ensuring access to affordable credit in the non-prime mortgage market. New Century offers its customers loans either with or without a prepayment charge. However, all things being equal, we charge our customers a significantly lower interest rate if they agree to have a prepayment charge included in their loan terms.[1]

[1] For example, for the year 2001 our customers with 2/28 ARMs (a mortgage fixed for the first two years that converts to a variable rate for years 3 through 30) with prepayment penalties received an interest rate that was on average 48 basis points lower than their counterparts who opted not to have a prepayment penalty. Likewise, our customers with 3/27 ARMs with prepayment penalties received interest rates an average of 74 basis points lower than their

We can afford to reduce the interest rate for borrowers who agree to a prepayment charge because those loans provide us a greater comfort level that we will be able to recoup our up-front origination costs and earn a return on our investment. A borrower who elects to have a two- or three-year prepayment charge is less likely to prepay during that period, which provides a greater likelihood of a stream of interest payments during that period to compensate the originator or the secondary market investor for its investment. In the event the borrower prepays his loan during the restricted period, the originator or investor will at least have the ability to recoup some of its costs by collecting the prepayment charge. That is why the secondary market pays more for loans with prepayment charges. The higher secondary market value translates into the lower interest rates we are able to offer to our customers who elect to have a prepayment charge included in their loan terms.

If state laws prohibit us from charging a prepayment penalty, we will be forced to compensate for prepayment risk through higher interest rates and origination fees. However, we know from experience that some prospective borrowers will not be able to afford higher payments or up-front costs, and consequently will be deprived of access to credit. In other cases, state laws may severely restrict or prohibit us from charging interest rates or fees that would enable us to absorb the risk.[2]

While state housing creditors like New Century will no longer be able to offer the lower interest rates by including a prepayment charge in the loan terms, federal thrifts will. This is the problem. The Proposed Rule will create a significant *disparity* between federally chartered thrift institutions and state housing creditors with respect to their ability to offer variable-rate mortgage loans.[3] We believe that this unfair result to state housing creditors is contrary to the intent of Congress in passing the Parity Act.

II. <u>Access to Credit Will Be Limited</u>

When state housing creditors are forced to pass through their higher compliance and secondary marketing costs, and are unable to reduce their rates and fees by charging a prepayment penalty, borrowers in those markets will be left with significantly fewer borrowing options.

Without vibrant competition in the non-prime mortgage market, federal thrifts might not be as hard pressed to offer competitive terms to non-prime borrowers. The cost of credit will rise or, even worse, access to credit will be severely restricted.[4]

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counterparts who decided against a prepayment penalty. The benefit to the borrower of an immediate rate reduction without cost is obvious.

[2] We do not originate "high-cost" loans as defined by applicable federal or state laws. As a result, our ability to price for risk is essentially capped.

[3] The OTS acknowledged as much in its April 1996 Chief Counsel opinion stating that "... state housing creditors would be 'disadvantaged vis-à-vis federal thrifts' if they had to comply with the state law restricting prepayment penalties".

[4] State housing creditors play a significant role in the non-prime market, as evidenced by the prominence of state housing creditors on rankings of non-prime mortgage originators in <u>Inside B&C Lending</u> (see, e.g.,

Ironically, it is this sort of environment of limited competition and fewer options that we believe is much more ripe for abusive lending practices.

III. No Link Established Between Parity Act and Abusive Lending Practices

We understand that a number of consumer groups and state consumer advocates have urged the OTS to eliminate the preemption of prepayment penalties from the Parity Act Regulations because they believe that the use of the preemption by some state housing creditors facilitates abusive lending practices. However, any evidence provided to the OTS to support this belief is admittedly anecdotal, and should not be used to persuade the OTS to take an action that would have the effect of eliminating the parity that Congress intended when the law was enacted in 1982.

Further, contrary to the picture painted by consumer advocates, we believe in most cases that prepayment penalties reduce the cost of credit, thus in turn making credit more available to consumers. Because lenders can offer products at lower cost when prepayment penalties are included, borrowers obtain an immediate cash flow advantage. There is no up-front cost associated with a prepayment penalty, as there is with 'discount points' that buy down the rate. In exchange for the up-front, no-cost rate reduction, consumers only pay a penalty if they choose to repay their loans in full during the term of the prepayment agreement.

IV. Conclusion

In closing, we would like to address a misconception that seems to underlie the assumption that the Proposed Rule will serve to limit abusive lending practices: namely, the misconception that state housing creditors are "unregulated." On the contrary, state housing creditors such as New Century are, in fact, heavily regulated by state licensing authorities and state and local lending laws. We undergo over a dozen rigorous examinations from various state regulatory bodies each year. The regulators review our loan files, our policies and procedures, our sales practices, our complaint and litigation history and other relevant information.

We are also subject to extensive federal law, such as the Truth in Lending Act, the Equal Credit Opportunity Act, the federal Home Ownership and Equity Protection Act and Regulation Z Sections 226.31 and 226.32. Additionally, we are subject to all state laws as they pertain to non-alternative mortgage transactions.

We submit that most abusive lending practices already violate applicable state or federal law. In our view, better enforcement of those laws will be far more effective in

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the February 11, 2002 and May 20, 2002 issues). In some markets, federal thrifts may not have the capacity or expertise to take over market share from non-prime lenders. Borrowers in those markets will be left the choice of paying the higher rates that state housing creditors will be forced by the Proposed Rule to charge, or not have access to credit at all.

combating abuses than the Proposed Rule would be. Likewise, abusive lending practices continue to be the subject of proposed federal and state legislation. We believe that these legislative efforts, perhaps in conjunction with overall mortgage reform, will be better suited to eliminating abusive lending practices.

We thank you for the opportunity to present this Comment to you in connection with this very important Notice of Proposed Rulemaking.

Very truly yours,

Stergios Theologides
Senior Vice President